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THE CONSEQUENCES OF THE FINANCIAL CRISIS UPON EMERGING AND DEVELOPPING COUNTRIES

Abstract
The authors of the research analyze the impact and the effects of the financial crisis upon the emerging and developping countries. Moreover, the impact of the international economic crisis upon the new member states of the European Union has proved to be more severe than it had been anticipated a few months before, and its effects appeared immediately. Also, the study shows how important it is for the developping countries to take immediate, decided and systematic measures, to be ready for future events, in order to reduce the recession risks. A correct management of the crisis besides prevention policies and strategies, also involves management methods corresponding to the type of crisis.

Keywords: drinking public, effects, crisis, measures, emerging

JEL CODES: H83, H12, R11, O11, F43

CONSECINȚELE CRIZEI FINANCIARE ASUPRA ȚĂRILOR EMERGENTE ȘI ÎN CURS DE DEZVOLTARE

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Rezumat
Autorii cercetării, analizează impactul produs de criza financiară asupra țărilor emergente și în curs de dezvoltare și efectele produse asupra acestor țări. De altfel, impactul crizei economice internaționale asupra noilor state membre din Uniunea Europeană s-a dovedit a fi mult mai sever decât se anticipa în urmă cu câteva luni, iar efectele nu au întârziat să apară. De asemenea, studiul arată cât de important este ca țările în curs de dezvoltare să ia măsuri de gestionare corectă a crizei, care presupune pe lângă politici și strategii de prevenire a acesteia și metode de management adecvat tipului de criză.

Cuvinte cheie: public, efecte,criză, măsuri, emergente.

1. INTRODUCTION

The great external unbalances increase the economy's vulnerability at the shocks associated to high volatility on the external markets, which lead to the currency depreciation and, finally, to a higher inflation. The keeping of the external unbalance at a sustainable level is due to the fiscal-budgetary policy. The fulfillment of the objectives regarding the continuous economic growth, on one hand, and the macro-economic stability, on the other hand, imply the stimulation of investments and the avoidance of the pro-cyclic character of the macro-economic policies. The public sector should restraint in order to offer a more extended maneuver space to the private sector. Revenues policy should remain prudent and not transmit inadequate signals for setting-up salaries within the private sector.

It is quite difficult to make appraisals when a financial crisis becomes an economic one or if an economic crisis generates a financial one.

2. OVERVIEW

The emerging economies' particularities, such as the predominance of the monetary substitution phenomenon extension, the fragility of the fiscal institutions, the low deep financial markets, vulnerability towards the sudden interruption of capital inputs and the work power's migration contribute to the enhancement of the complexity of the monetary policy decisions intended for the achievement of the prices' stability objective. The advanced countries are not immune against the problems connected to the fiscal, financial and monetary institutions, but, there is a major difference concerning the seriousness of this problem within the counties with emerging markets (Mishkin, 2004).

The classification made by the Financial Valuation Agency Standard & Poor's regarding the most vulnerable emerging markets in case of credit crisis aggravation at a global level, highlights that Romania is on the third place after Island and Lebanon[1].

Likewise, within a top of the most vulnerable emerging European countries to the pressures connected with the external financing, Romania stands on the fifth position, on a par with Estonia. The first place within the Fitch top is held by Latvia, followed by Croatia, Lithuania and Turkey. (Vlad, 2008). Fitch sustains the measures of the regulation authorities regarding the increase of the minimum level of the

[1] http://economie.hotnews.ro/stiri-finante_banci-2852925-romania-afla-printre-tarile-emergente-cele-mai-vulnerabile-cazul-agravarii-crizei-creditelor.htm

Banks' compulsory capital, the solvability rata of 12% being considered as adequate, by the Agency, for most of the European emerging countries, within the actual operational environment[2].

The states in the Eastern Europe are the most vulnerable emerging markets in case of the crisis deterioration, according to Standard & Poor's report called "Why could the global credit crisis affect more the states on the emerging markets than other states", quoted by Mediafax. Within the report it is shown that the vulnerability degree of each state depends on its dependence upon the foreign currency inputs for financing the current account deficit and crises avoidance from this point of view. According to this, the states with high vulnerability are in Europe, excepting Lebanon and South Africa. Island is on the first place within the classification, being followed by Lebanon, Romania, Latvia and Turkey. Hungary and Bulgaria are on the seventh and eights places within the said classification. The least vulnerable emerging state is Chile, as result of the favorable evolution of the current account, followed by China, Venezuela, Trinidad, Tobago and Nigeria, and Russia is the only emerging state in Europe that belongs to the least vulnerable states group[3].

3. WHAT ARE THE EFFECTS OF THE CRISIS IN THE EMERGING COUNTRIES AND IN DEVELOPING COUNTRIES?

The answer could be in the differentiation degree, for each "emerging" country, between what is called in EU "the nominal convergence" and, respectively, "real convergence" with the countries of the mature capitalism. Probably the type of crisis will greatly depend on the coverage degree, from country to country, of mass prosperity (relative). Undoubtedly, the financial and economic crisis declared in 2007 will produce the most dramatic effects, especially in the countries where the population's income are the lowest.

A first factor is the reduced access to external financing, under the conditions when the external financing needs are lower for the countries that have a current account deficiency less than 10% of the GIP (Czech Republic, Hungary, Poland, Slovakia and Slovenia) and greater for the countries that recorded a current account deficiency greater than 10% of GIP (the Netherlands, Bulgaria and Romania) (Cerna, 2008).

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[2] http://www.mediafax.ro/economic/fitch-sistemele-bancare-din-europa-emergenta-continua-sa-aiba-probleme-structurale-5150831

[3] http://economie.hotnews.ro/stiri-finante_banci-2852925-romania-afla-printre-tarile-emergente-cele-mai-vulnerabile-cazul-agravarii-crizei-creditelor.htm

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A second factor that explains the differentiated impact of crisis over the said countries is the status the Bank system is. The international Banks, especially from the countries that are EU members, play a very important role in the new member states and the behavior of the said Banks within the actual context is the one that mostly determines the credit's availability and the Bank system stability. On its turn, the said behavior depends on the refinancing needs of mother Banks, the incentives aiming the abatement of the obligation degree within the actual crisis context and the increased risks that come from the exchange rate adjustments and from the macroeconomic decline. The Banks – mother Banks fix for the Banks subsidiaries – in the emerging countries very ambitious profitability targets, usually ROE between 20 and 25% (before taxation). This stimulates the Banks – Subsidiary Banks to aggressively extend the non-governmental credit, sometimes in these ones' quality detriment. If the Bank – Mother Bank does not have a team of analysts to monitor the situation in each country, the problem agent–principal occurs, problem in which:

- The Mother Bank has a low exposure towards every emerging market, having no incentives to monitor them individually;
- The Subsidiary Bank has incentives to force the increase of ROE through an under-estimation of risks/provisions.

Within this context, the materialization of a risk within an emerging country may determine its quickly spreading in the whole region.

Besides the fact that the Banks in the EU exposure on the Central and Eastern Europe markets is relatively small, the said exposure is still more insignificant on the South-East Europe markets (are Romania is included too) amplifying the risks of an agent-principal problem.

TABLE 1: BANKS EXPOSURE WITHIN EU COUNTRIES IN SEE (% OF THE TOTAL EXPOSURE IN ECE)

Country of the Mother Bank Exposure	Italy	Austria	France	Holland	Germany
Total out of which:	33,4	24,3	12,1	11,7	5,5
– in Croatia	27,4	14,4	1,0	0,4	2,7
– in Romania	3,5	4,9	8,9	10,6	1,6
– in Bulgaria	2,4	3,4	1,4	0,7	0,8
– in Serbia	0,2	1,6	0,8	0,1	0,3

Source: Craig – "The Expansion of Foreign – Owned Banks in Emerging Europe: Implications for Surveillance" – Oct. 2006

Thus, a sudden interruption of the Bank credit coming from outside the country (not necessarily generated by local causes, but by regional contagion) could suddenly deteriorate the capital account and the currency reserves level. The question is then put at what extent the Mother Banks know sufficiently well the concrete situation from the host countries, in order to issue pertinent valuable decisions and to diminish the risk of regional contagion.

Within the Fitch report regarding the Bank systems from the emerging Europe, which analyze the situation from 12 states in the region, it is shown that the Bank systems with a high level of financing and capital flexibility, like those in Turkey, the Czech Republic, Slovakia and Poland have a better situation than the rest. On the other hand, Bank systems like those from Lithuania, Latvia and Romania seem to depend more on the guarantees for loans, in order to protect against the credit risks, thus being exposed to a decrease of the said guarantees, like the real estate ones.

A third differentiation factor is the exchange rate type. Countries such Slovakia and Slovenia have joined the ERM mechanism (exchange rate mechanism) giving up the possibility of making adjustments of the exchange rate and of being able to have an independent monetary policy. Countries like Estonia, Lithuania and Bulgaria have a fixed exchange rate regime and also, economies with a floating course - The Czech Republic, Hungary, Poland and Romania. The World Bank report highlights that the countries that have a floating regime registered a sudden depreciation of the exchange rate during the financial crisis (Soros, 2008).

Within the emerging countries and the developing countries this crisis affects all fields of activity, registering negative effects such as:

- reducing of the economic increasing rhythm in the emerging countries and in the developing countries (the economic increase in the emerging and in the developing countries decreased to a quarter from the one recorded in 2007 and to a quarter form the increase recorded in 2008. The Russian Federation bore a profound recession in the year 2009, with a decrease of 7.9% from the GIP, especially caused by the quite reduced internal demand. The recession was very strong in Ukraine too, that considerably reduced the real increase rhythm from 2.1% in the year 2008 up to minus 15.0% in the year 2009, recording the most severe decrease from the last 15 years. The 27 countries of the European Union recorded during the year 2009 a reducing rate of the economy of 4.2%, compared to plus 0.9% in the year 2008, inflation being at the level of 1.5%.);
- the increase of the unemployment rate (increase, especially recorded in the urban areas, thing that could determine an increase of the immigrants' flows);

- the reduction of prices and of the revenues obtained from the raw materials;
- the reduction of the commercial exchanges and the increase of the commercial restrictions (whereas a slow down of the export volumes has been foreseen as being greater in case of the advanced economies than for the developing economies, the latter could have more to suffer following the decline with regard to the trade – especially in case of consumer goods exporters);
- more difficult access to the international financing and less external investments;
- the protective reaction of the developed countries, that limits the export capacity of the developing countries;
- diminishing of revenues and transfers of the immigrants funds, which recorded a decrease of 7% in the year 2009 compared to year 2008, what especially affects the countries with the lowest revenue, where the said funds represent almost 6% of GIP;
- a greater obligation. The total value of the external debts of the emerging and developing countries increased with two percentage points from GIP in one single year;

Within most of countries there is a political pressure for a quick enactment of the reforms, but, there is the risk that on a certain extent the reforms be incoherent among the different regions of the world. The boosting profile is not the same in all countries. In the countries that have borne a financial crisis, boosting is much more modest than in the countries that suffered because of the world demand's reduction. Inflation in the advanced countries almost reached zero (0.1%) in year 2009, while in the emerging countries this reached the value of 5.2%. The significant increase of the public debt and of the budgetary deficit against GIP of a series of EU member states, like Greece, Italy, Spain, Ireland and Portugal, contributed to the depreciation of the pair USD/EURO, thing that created a situation of economic incertitude in the region, with negative effects over the Euro zone image.

The actual crisis tapped the attention of the whole world and exceeds the boundaries of the initially affected sectors. "A tsunami of credits that occurs once a century" as it is defined by some specialists, whose profound cause is to be found in the American real estate sector, exceeded the national boundaries within the developed countries, affecting now the emergent and the developing countries. The instability wave has propagated from one sector to another, first in the real estate sector, in the Bank one and in other financial markets, and then, in all real economy fields (Isarescu, 2008)

The exports from the Central and Eastern Europe (CEE) are strongly correlated with the ones in the EURO area (Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Island, Italy, Luxemburg, Malta, Holland, Portugal, Spain, Slovenia, and Slovakia).

The first estimate for the March 2010 extra-EU27 trade balance was a 7.1 bn euro deficit, compared with -9.2 bn in March 2009. In February 20102 the balance was -6.5 bn, compared with -10.8 bn in February 2009. In March 2010 compared with February 2010, seasonally adjusted exports rose by 7.0% and imports by 10.4%. (These data are released by Eurostat, the statistical office of the European Union: http://epp.eurostat.ec.europa.eu).

3.1. Decline of the direct foreign investments

The portfolio investments will decrease, and the countries that will be able to access the capital will have to pay higher interests, because of the flight to more secure markets and of the greater aversion to risks.

The decrease is to be accentuated too, because of the high investments inflow in the last five years. An extremely great number of investment projects are already in process of achievement. As long as the investments' financing decrease, it is possible that two consequences occur, both evil. In some cases the projects will not be achieved and, consequently, they will become non-productive and will overload the accounting balance of the Banks with non-performant loans, and in the other cases, if the projects are completed, they will create a surplus production capacity resulted from the global slow down, thus, increasing the deflation risk.

The profitability of most of the multinational companies have been affected by the increase slow down, and the tightening of the credit conditions and the decrease of demand on the global plan will limit the capacity and wish for extension of the multinational companies. In 2008, the direct foreign investments increased in Romania and Hungary with over 1% of GIP. Within the first two months of 2009, the direct foreign investments had a positive evolution in Romania, Hungary and Lithuania, but they decreased in annual rhythm with almost 30% in Bulgaria and Poland, and with more than a half in the Czech Republic, Estonia and Latvia.

The global slow down will reduce the demand for consumption goods and industrial products, reducing the gains from exports, and as the work force markets decrease, the employees will suffer because of the disproportionate impact over their revenues. The unemployment rate will record significant increases in all developing countries and emerging countries, thus, in Estonia this was situated at 4.7% in 2007, 5% in 2008 with the prevision that it could reach 7.7% in 2010. In Lithuania unemployment will rise from 4.3% to 7.7% until the end of year 2010. In Spain there are previsions of an increase from 8.3% to 15.5% for the same period. In Ireland from 4.6% to 7.5%. By reducing the demand for consumer goods a series of enterprises will be in bankruptcy or they have significantly reduced the number of employees and implicitly the salaries. All the said factors will have as a consequence the decrease of GIP from the majority of the emerging countries, including Romania.

3.2. Unemployment evolution

In the past the major crises in the developing countries concentrated on the regional level – as in case of Eastern Asia between 1997-1998 or of "tequila" crisis from the Latin America that took place in 1995. The epicenter of the actual crisis is situated in the developed economies, and that is why we consider that all developing regions will be affected by shocks. The achieved surveys show that among the EU member states, 10 are already in recession, recording a decline of the economic activity of 3% in the year 2009, the unemployment rate increasing from 6.5% in 2008 to 10.4% in 2010, or from three to five million persons.

First estimate for the third quarter of 2009 Euro area and EU27 employment down by 0.5%,-2.1% and -2.0% respectively compared with the third quarter of 2008. All sectors of the economy recorded a decrease in employment, except other services (which mainly includes public administration, health and education), which grew by 0.3% in the **euro area** and by 0.2% in the **EU27**. Decreases were recorded in construction (-2.0% and -1.9% respectively), manufacturing (-1.7% and -1.6%), agriculture (-1.1% and -0.4%), financial services & business activities (-0.5% and -0.4%) and trade, transport & communication services (-0.1% and -0.2%). Compared with the same quarter of the previous year, employment fell by 2.1% in the **euro area** and by 2.0% in the **EU27** in the third quarter of 2009. In the second quarter of 2009, employment decreased by 1.8% and 1.7% respectively.

More than that, the effects felt by the developing countries may not limit to a slow down of GIP and of the incomes coming from investments and exports. There is the danger that each of the emerging markets enters an individual crisis (their own assets market collapses and their own Bank sectors weaken). The drastic fall down of the Stock Markets in the developing countries have already indicated the investors' concerns regarding the future, and the decline of the portfolios value decline may also have significant effects of wealth over consumption, stressing the slow down's effects.

In Romania, the economic increase during the period 2005-2009 has not been generated by the external demand, as it would have efficiently been, but, by the internal demand, representing the population's consumption, the governmental consumption and investments, mostly non-productive –

that inadequate increase accumulative creating macroeconomic unbalances. The production decrease also lead, in Romania to the decrease of the turnover in commerce and services beginning with the month of July, 2008, exacerbating in the year 2009, and implicitly leading to the bankruptcy of some enterprises and unemployment increase. If in 2004 there was recorded an economic growth of 8.5% at an inflation of 9.3% with a fiscal deficit of 1.5% of GIP and a deficit of the current account of 8.4% of GIP, in the year 2008 there was recorded an economic growth of 7.9% at an inflation of 6.3%, with a fiscal deficit of 4.8% of GIP (twice bigger than the foreseen one) and with a deficit of the current account of 13.5% of GIP. The unemployment rate in Romania reached in January, 2009, 5.6%.

4. CONCLUSIONS

The future previsions of the World Bank underline now a global increase rate much less, and if the taken measures do not succeed to revitalize the loans, the recession could be accentuated. The aggrandizement of the macroeconomic policies – including their fiscal and external policies – in many cases made them less vulnerable. The most pessimistic scenarios are unavoidable, and the combination of coordinated political interventions, efficient plans for the financial sectors and lower prices for the consumer goods may contribute to the reduction of the crisis effects. With regard to the fiscal policy, the administrations of the developing and emerging countries have a multitude of instruments in order to attenuate the shock strike. The governments disposing of a certain fiscal freedom may react using certain fiscal incentives, well projected in their economies, able to generate a demand at internal level, which might compensate the decline of the demand on the external markets. Equally, another important sector is represented by social insurance and the human development, in order to prevent the transformation of a temporary shock into a severe permanent decline of the wealth of the poorer administrations. Governments must grant priority to the protection and extension of those that can attenuate the crisis' effects over the poorest administrations. Examples of such programs: "Cameron 2002" – Indonesia – granting of workplaces within the public works field or of wealth based on work (India), and subventions for the inferior quality products consumption (those that are mostly consumed by the poor population). The ability of the countries to react at the crisis is determined by the lower or bigger possibilities of the emerging markets of taking anti-cyclic prudent measures for the internal demand increase, without affecting the fiscal position, the level of debts, the internal inflations' rates and the financial strength of their Bank sectors.

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